

In the Matter of:

CC Docket No. 96-45 /

CC Docket No. 96-262

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

## REPLY OF GTE

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**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554**

In the Matter of:	)	
	)	
Federal-State Joint Board on Universal	)	CC Docket No. 96-45
Service	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	

**REPLY OF GTE**

GTE Service Corporation and its affiliated domestic telephone operating companies (collectively "GTE")<sup>1</sup> respectfully submit their Reply to comments on the Further Notice of Proposed Rulemaking in the above-captioned docket.<sup>2</sup> As highlighted by the comments and the Fifth Circuit Court of Appeals' recent decision, it is critical that the Commission provide sufficient support for the high-cost universal service fund. However, it is equally important that the Commission do so in a manner that does not

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<sup>1</sup> GTE Alaska, Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Hawaiian Telephone Company Incorporated, The Micronesian Telecommunications Corporation, GTE Midwest Incorporated, GTE North Incorporated, GTE Northwest Incorporated, GTE South Incorporated, GTE Southwest Incorporated, Contel of Minnesota, Inc., GTE West Coast Incorporated, and Contel of the South, Inc.

<sup>2</sup> *Federal-State Joint Board on Universal Service; Access Charge Reform*, FCC 99-119, Seventh Report & Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, Fourth Report & Order in CC Docket No. 96-262 and Further Notice of Proposed Rulemaking (rel. May 28, 1999) ("Order and FNPRM").

rely on implicit subsidies. Without these prerequisites, the competition that is the goal of the 1996 Act will never emerge.<sup>3</sup>

## **I. INTRODUCTION AND SUMMARY**

In general, although the parties have vastly differing ideas on how the federal high-cost mechanism should be implemented, the comments on the Order and FNPRM demonstrate that it is essential for the Commission to adopt a plan that provides sufficient high-cost funding without implicit subsidies. The Fifth Circuit's recent decision confirms that sufficient funding and the elimination of implicit support are critical both for compliance with the Act and for the development of competition. Therefore, the Commission should not artificially limit the size of the fund and should not rely on averaging to calculate and distribute high-cost funding.

*High-cost mechanism parameters.* Regardless of the size of the high-cost fund, the Commission must ensure that federal high-cost support is distributed equitably. In particular, the Commission must consider the interaction of the benchmark, the payout schedule, and the state effort contribution. All of these variables are interdependent. Because of the vagaries of the Commission's cost model's results, their interaction can result in an unreasonable distribution of high-cost funds so that a few states get substantial funding while other states with similar need receive little or no funding.

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<sup>3</sup> In this Reply, GTE responds to other parties' comments on the majority of issues raised in the FNPRM. Some of the issues raised by GTE in its Comments were not addressed by other parties. GTE does not reiterate its position regarding those issues herein, but urges the Commission to adopt GTE's recommendations with respect to these issues.

In particular, when a high level of state effort is combined with other parameters to produce an artificially small fund size, the resulting distribution is unreasonable. Two states receive more than half of the entire fund, and many states which have high average costs, and apparently limited state resources, receive little or no support. However, if the parameters are chosen to produce a more reasonable fund size, then a moderate amount of state effort will not produce such a skewed distribution.

*Federal implicit subsidies.* The Act requires that the Commission eliminate implicit subsidies for universal service funding. To do this, high-cost funding must be calculated and distributed using deaveraged geographic areas, such as wire centers. Otherwise, low-cost areas will continue to subsidize high-cost areas. Parties that urge reliance on averaging to limit the size of the fund are misguided. Averaging undermines competition and must be eliminated if competition is to succeed in the residential market. Portable, deaveraged high-cost support will encourage competitive entry into high-cost areas while deterring uneconomic entry into urban, and particularly business, markets. Eliminating averaging and increasing the size of the universal service fund will not, as Cincinnati Bell fears, make ILECs less competitive as long as the support is provided in a competitively neutral manner, and ILECs are not required to recover their contributions via implicit subsidies in access charges.

*State implicit subsidies.* Similarly, states are also required to eliminate implicit subsidies, such as intrastate rate averaging. Such averaging undermines competition in higher-cost areas, while encouraging uneconomic entry into lower-cost areas. This uneconomic entry eats away at the subsidies that inflated business rates provide for

residential service, making the overall implicit subsidy chain even less sturdy. To encourage the states to remove these subsidies, the Commission should require that states that receive federal high-cost support transition to deaveraged intrastate rates.

*Use of high-cost funds.* The Commission should rely on market forces to ensure that universal service support is used consistent with Section 254. As long as funds are distributed on a deaveraged basis and are portable with the customer, carriers will have incentives to use the funds in high-cost areas. If they do not, they will not be able to provide high quality services, and the carriers will lose both the customers and their subsidies. However, for market forces to be effective, the Commission must require that each eligible carrier offer a basic local service package at an affordable rate. Otherwise, carriers may simply offer expensive bundles of services that only a small percentage of customers will be able to afford, and there will be no assurance that universal service funds are being used to maintain widespread availability of the basic service the Commission has designed its program to support.

*Hold-harmless policy.* Most commenters support the application of the hold-harmless policy on a carrier-by-carrier basis to ensure that sufficient funds are provided to avoid rate shock. As long as this support is portable, it will be competitively neutral and will encourage CLEC entry into high-cost markets.

*Access charges.* AT&T, Bell Atlantic, BellSouth, GTE, Sprint, and SBC recently submitted a comprehensive access reform and universal service proposal to the Commission. This plan goes a long way towards meeting the requirements of the Act and will help eliminate implicit subsidies in intrastate access, replace such subsidies

with explicit support, and lead to lower long distance charges. GTE urges the Commission to put this proposal on public notice as soon as possible and to permit its implementation by January 1, 2000.

**II. THE COMMISSION CANNOT ASSUME THAT THE CURRENT SIZE OF THE HIGH-COST FUND IS SUFFICIENT.**

Section 254 of the Act requires that there be "specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service."<sup>4</sup> Indeed, the Fifth Circuit Court of Appeals recently stated that "the plain language of § 254(e) makes sufficiency of universal service support a direct statutory command."<sup>5</sup> However, the Order and FNPRM simply assumes that the current level of funding is adequate, even in the face of substantial evidence that this is not the case. As GTE explained:

[t]he Commission, state PUCs, and the industry must recognize that the mechanism adopted by the Commission will not calculate the total need for universal service support. Rather, by focusing only on high-cost support, it is designed to determine only the level of additional resources the federal plan must provide to enable states to achieve "reasonably comparable" rates.<sup>6</sup>

Other parties echo GTE's concerns. MCI WorldCom states that "[t]o fully execute the Act, the amount of subsidy necessary to keep rates affordable and comparable must be identified....Unfortunately, the Order and Further Notice stray from

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<sup>4</sup> 47 U.S.C. § 254(b)(5).

<sup>5</sup> *Texas Office of Public Utility Counsel, et al. v. FCC*, 1999 U.S. App. LEXIS 17941, at 20 (5th Cir. July 30, 1999) ("USF Opinion").

<sup>6</sup> Comments of GTE, CC Dockets Nos. 96-45 and 96-262, at 14 (filed July 23, 1999) ("GTE Comments") Unless otherwise noted, all comments cited herein were filed in CC  
(Continued...)

these requirements.”<sup>7</sup> Similarly, U S WEST cautions that “[i]n constraining the new fund to be not significantly larger than the old, the Commission and the Joint Board rely on vague and generalized assumptions about the lack of local competition. Absent is any data or analytical support for the level of competition that leads to this conclusion.”<sup>8</sup>

Although some parties agree with the Commission that the current level of funding is sufficient, they provide no evidence that this is the case, nor could they. AT&T states that “[c]onsistent with the Joint Board’s recommendation, the Commission ‘should *not* increase the amount of explicit federal support significantly from current explicit levels.’”<sup>9</sup> However, AT&T relies solely on the Commission’s and Joint Board’s conclusions, which, as explained above, are supported only by conjecture and assumption.

Cincinnati Bell (CBT) also urges the Commission to limit the size of the fund to its current size. However, it honestly admits that it is concerned about its ability to compete, rather than whether there is sufficient high-cost funding:

CBT’s analysis concludes that the larger the fund becomes, the greater CBT’s contribution, which in turn, increases CBT’s access charges for purposes of recovery. As CBT’s access charges increase, CBT becomes less competitive and more vulnerable to the threat of carrier bypass. Such an outcome would be an inappropriate and unintended

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(...Continued)

Docket Nos. 96-45 and 96-262 on July 23, 1999.

<sup>7</sup> Comments of MCI WorldCom at 3 (“MCI WorldCom Comments”).

<sup>8</sup> Comments of U S WEST, Inc. at 5 (“U S WEST Comments”).

<sup>9</sup> Comments of AT&T at 7 (emphasis in original) (citation omitted) (“AT&T Comments”).



result of the universal service support process, a result which the Commission must guard against.<sup>10</sup>

CBT's concern demonstrates that it is critical for the Commission: (1) to develop a competitively neutral high-cost funding mechanism; (2) to remove implicit subsidies from access charges; and (3) to act quickly to implement the Fifth Circuit mandate regarding the recovery of ILEC universal service contributions. When ILECs no longer recover universal service costs through access charges (as required by the Fifth Circuit's decision), increases in the high-cost fund will not put ILECs at the competitive disadvantage CBT fears.

CompTel's assertion that a smaller high-cost fund will encourage ILECs to provide more efficient service is absurd. CompTel claims that:

using study areas for averaging costs would create a beneficial incentive for ILECs to serve their high-cost areas efficiently. By averaging costs at the study area level, the Commission would effectively require the ILECs to share some portion of their efficiency gains in lower-cost areas with customers in high-cost areas. Under that approach, the ILECs have an incentive to become more efficient in high-cost areas in order to retain a higher percentage of their efficiency gains in lower-cost areas.<sup>11</sup>

Contrary to CompTel's assertions, insufficient high-cost funding will: (1) prevent ILECs from investing in high-cost areas, (2) discourage competitive carriers from entering high-cost markets, and (3) provide a windfall to entrants in lower-cost areas. Rather

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<sup>10</sup> Comments of Cincinnati Bell Telephone Company at 2 ("CBT Comments").

<sup>11</sup> Comments of the Competitive Telecommunications Association at 3.

than more efficient service, the overall result will be no competitive choices and lower quality service in high-cost areas.

The Fifth Circuit has confirmed that the Commission must ensure sufficient funding to provide high-cost customers with service at affordable and reasonably comparable rates. However, if the Commission maintains the fund at its current size and implements a hold-harmless policy, there will be no additional funds available for support to high-cost areas. This cannot be what Congress had in mind in adopting Section 254 of the Act. Therefore, the Commission should not arbitrarily limit the fund to its current size.

**III. IF THE COMMISSION LIMITS THE HIGH-COST FUND, IT SHOULD CHOOSE PARAMETERS THAT ALLOW STATES A REASONABLE OPPORTUNITY TO MAINTAIN COMPARABILITY AND THAT TREAT ALL AREAS THE SAME, REGARDLESS OF THE SIZE OF THE COMPANY THAT SERVES THEM.**

Several parties have argued that the choice of parameter values is arbitrary.<sup>12</sup> This is partially true. As GTE noted in its Comments, the Act does not specify a particular division of funding responsibility between the federal and state jurisdictions. What is required is that the state and federal programs together provide sufficient support so as to ensure affordable and comparable rates. Thus, there is no "ideal" set of parameters, but rather a need to consider all of the factors – the benchmarks, the payout schedule, and the state effort contribution – together.

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<sup>12</sup> MCI WorldCom Comments at 5; Comments of Ameritech at 9 ("Ameritech Comments").

**A. The Commission must choose a benchmark that produces reasonably comparable rates.**

The model proposed by the Commission does not attempt to calculate the need for high-cost support, but rather leaves this responsibility to the states. As the Non-Urban States note, the announced purpose of the plan is to provide the resources necessary to maintain reasonable comparability.<sup>13</sup> The model proposed by the Commission suggests that to achieve this objective, the high-cost fund should be at least \$1.6 billion.<sup>14</sup>

Nonetheless, the Commission appears unwilling to provide this level of funding. The Commission must examine carefully the results of its own model and not arbitrarily limit the level of funding to what is currently provided. However, if the Commission determines that it must limit the size of the fund, it should adopt one of the two alternative sets of parameters outlined by GTE in its Comments.<sup>15</sup> First, the Commission could set the state effort contribution at zero and provide 15 percent of the cost above 115 percent of the nationwide average cost, 60 percent of the amount above 160 percent, and 75 percent of the amount above 200 percent. This would yield

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<sup>13</sup> Comments of the Arkansas, Maine, Montana, New Hampshire, North Dakota, Vermont, West Virginia and Wyoming State Regulatory Agencies at 7 ("Non-Urban States Comments").

<sup>14</sup> This \$1.6 billion is the funding needed to ensure comparable rates, according to the Commission's model and data. This is not to be confused with the explicit support needed to replace the implicit subsidies currently in ILEC access charges. See section VII below.

<sup>15</sup> GTE Comments at 31-33.

a federal non-rural fund of \$713 million, based on Commission data. Second, the Commission could produce the same size fund by providing 65 percent of the amount above 115 percent of the nationwide average, and 75 percent of the amount above 150 percent with a state effort amount per line of \$1.25. Either of these strategies would produce a more reasonable distribution of support to achieve reasonable local rate comparability than the parameters recommended by other parties.

The Commission should not adopt an unreasonably high benchmark to cap the fund, as some commenters recommend. For example, AT&T suggests a benchmark of 200 percent.<sup>16</sup> However, as the Non-Urban States show, a 200 percent average cost benchmark will not produce rates that are reasonably comparable. In fact, using the Commission's model, the Non-Urban states show that even a benchmark of 115 percent, as recommended by the Joint Board, will produce "a maximum net rural cost that is 172 percent of the urban cost. 172 percent is clearly not within the range of 'reasonably comparable.'"<sup>17</sup>

**B. If the Commission uses a state effort contribution, it must choose a number that leads to a reasonable distribution of funds.**

Similarly, a large amount of state effort, such as \$2 per line, when combined with the vagaries of the cost model's estimates, produces a distribution of support that is patently unreasonable. As GTE has shown, a substantial state effort contribution

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<sup>16</sup> AT&T Comments at 12-13.

<sup>17</sup> Non-Urban States Comments at 14-15.

causes almost all funding to go to only two states.<sup>18</sup> In contrast, when state effort is set at a lower level, funding is more reasonably distributed among several states.

The benchmark calculation, to which the state effort amount is added, is not a measure of the funding need in each state; it merely compares the mean of the state cost distribution to a multiple of the national mean, for purposes of assessing the resources needed to maintain reasonable comparability. GTE has shown that two states with the same mean cost but different variances may have to raise and distribute very different amounts of state universal service funding.<sup>19</sup> Therefore, when the Commission subtracts a fixed dollar amount of state effort from the result of the benchmark calculation, it is mixing apples and oranges – the state effort is meant to serve as a proxy for state resources, but the result of the benchmark calculation is not a measure of state need. If a state with a high variance in its costs has to raise a larger amount of state universal service funding to eliminate implicit support between its high and low cost areas, then it will have fewer resources to ensure overall comparability of rates than another state with the same mean, but a lower variance.<sup>20</sup>

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<sup>18</sup> GTE Comments at 31-33. See *also* AT&T Comments at 13 (noting that “because of the relative costs in the FCC’s Synthesis Model, if the Commission were to establish a national cost benchmark between 115% and 150% of the nationwide study area average, as recommended by the Joint Board, only one state would receive supplemental federal support if the Commission were to hold true to its objective of approximating the current explicit high cost fund”).

<sup>19</sup> The Non-Urban states present a similar example which shows that the amount of universal service funding a state must raise depends on the variance of its costs, and not simply on the mean. Non-Urban States Comments at 17.

<sup>20</sup> *Id.* at 15-17.

The state effort contribution magnifies the other weaknesses in the Commission's proposed structure. As several parties point out, the Commission's cost model produces cost estimates which vary in an unpredictable fashion across geographic areas.<sup>21</sup> If parameters are chosen artificially to limit the size of the fund, the state effort calculation will highlight those states for which the model's estimates are outliers, by weeding out states with estimates closer to the national average. If the payout schedule is chosen so that only a small proportion of the cost above the benchmark is covered, then the state effort calculation will reduce the funding for these states. For similar reasons, if the payout schedule discriminates between large and small study areas, the state effort calculation will magnify the effect of that discrimination.<sup>22</sup>

Precisely because the state effort variable is arbitrary, its usefulness can only be judged by the results it produces. When a high level of state effort is combined with other parameters to produce an artificially small fund size, the results are clearly not reasonable. Two states receive more than half of the entire fund, and many states

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<sup>21</sup> See, e.g., Comments of Bell Atlantic at 3-4 ("Bell Atlantic Comments"); Comments of Sprint Corporation at 5-7 ("Sprint Comments").

<sup>22</sup> As GTE explained in its Comments, the same benchmarks and support levels should apply to companies regardless of their size. GTE Comments at 19. Establishing disparate benchmarks or support levels based on a company's revenues or access line count would continue the implicit subsidies in the current system, which both violate the Act and undermine competition. In addition, the level of support must be based on the actual cost of serving a particular customer and be portable if there is to be competition in high-cost areas.

which have high average costs, and apparently limited state resources, receive little or no support.<sup>23</sup>

**IV. THE STATES AND THE COMMISSION CANNOT CONTINUE TO RELY ON IMPLICIT SUBSIDIES TO SUPPORT SERVICE TO HIGH-COST AREAS AND MUST THEREFORE CALCULATE AND DISTRIBUTE HIGH-COST SUPPORT ON A DEAVERAGED BASIS.**

Replacing all implicit support in federal and state rates with explicit support is both required by the Act and a necessary precondition for competition in the residential market.<sup>24</sup> The Fifth Circuit's recent decision confirms this point, holding that: "the plain language of § 254(e) does not permit the FCC to maintain any implicit subsidies for universal service support."<sup>25</sup> As the court explained:

For obvious reasons, this system of implicit subsidies can work well only under regulated conditions. In a competitive environment, a carrier that tries to subsidize below-cost rates to rural customers with above-cost rates to urban customers is vulnerable to a competitor that offers at-cost rates to urban customers. Because opening local telephone markets to competition is a principal objective of the Act, Congress recognized that the universal service system of implicit subsidies would have to be re-examined.<sup>26</sup>

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<sup>23</sup> It is not surprising that attempting to choose parameters that force the fund to match the current fund size produces unreasonable results. As U S WEST demonstrates, even using the Commission's cost estimates and considering a wide range of parameters, the fund size produced is substantially larger than the current level. However, the use of state effort as a means for forcing the fund size down has an even more arbitrary effect on specific states than does manipulation of the other parameters. U S WEST Comments at 8-9.

<sup>24</sup> GTE Comments at 3-4.

<sup>25</sup> USF decision at 66.

<sup>26</sup> *Id.* at 4.

Using study areas to calculate high-cost support will create implicit subsidies by averaging the costs across areas with different costs characteristics. The actual needs of high-cost areas will be hidden because they will be offset by the lower costs of other locations in the same study area. As the court recognized, this will create inefficient entry into low-cost areas, putting the incumbent at a competitive disadvantage. However, equally as important, such a policy will discourage competitive entry into high-cost areas because sufficient funding will not be available to meet the actual costs of serving these areas.

GTE urges the Commission to use state zones comprised of granular geographic units, such as wire centers, for the calculation and distribution of high-cost support. Using small areas is consistent with the Act's goals and requirements. First, using smaller areas will target high-cost customers, ensuring that support will be sufficient to meet their needs and that their rates are comparable to lower-cost areas and affordable. Second, basing costs on small areas will avoid the effects of averaging. High-cost areas will not be offset by lower-cost areas, eliminating implicit subsidies as required by the Act. Third, with a sufficient amount of portable support available, CLECs will have incentives to enter high-cost areas and competitive choice will be available to rural, as well as urban, consumers.

Despite the problems caused by the implicit subsidies, some commenters urge the Commission to use study areas precisely to take advantage of averaging costs over large areas. AT&T states that "calculation of subsidies at the wire center level would result in a larger fund because it fails to take into account the mitigating impact of low



cost wire centers in the same study area.”<sup>27</sup> Similarly, the New York State Department of Public Service (NYDPS) asserts that federal high-cost support based on deaveraged areas “would substitute interstate for intrastate cost recovery to a greater degree than warranted. For example, where intrastate rates in a study area already meet the Act’s affordability and comparability standards *without* any federal high cost support, one might still show an apparent need for federal support in the higher cost parts of that study area by calculating that need at the wire center on UNE zone level.”<sup>28</sup> GTE agrees with the NYDPS that additional support may result from using smaller areas; this is precisely what is necessary to comply with the Act’s requirements of ensuring sufficient funding and eliminating implicit subsidies. Since use of study areas would continue federal implicit subsidies, there is no question that they cannot be used for calculating and distributing universal service support

Moreover, GTE explained in its Comments that the Commission’s conclusions regarding state implicit support were incorrect. In the Order and FNPRM, the Commission asserted that “the 1996 Act does not require states to adopt explicit universal service support mechanisms,”<sup>29</sup> and that “states should not be required to alter their existing substantial universal service support mechanisms, such as intrastate

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<sup>27</sup> AT&T Comments at 14.

<sup>28</sup> Comments of the New York State Department of Public Service at 7-8 (emphasis in original).

<sup>29</sup> Order and FNPRM, ¶ 45 (footnote omitted).

rate averaging” and value of service ratemaking, “to receive federal support.”<sup>30</sup> The Commission should reconsider both of these assertions. First, states are required to remove the implicit subsidies from intrastate rates. Otherwise, their regulations are inconsistent with the Commission’s rules on universal service which rely on competition. Second, states must be required to eliminate intrastate rate averaging and value of service ratemaking to receive federal support.<sup>31</sup> If the Commission continues to allow states with implicit subsidies to receive federal support, it will be providing implicit support for rate averaging which is the most significant factor preventing the development of widespread residential competition.

Some commenters misconstrue the states’ obligations, claiming that there is no need for states to eliminate implicit subsidies until full local competition has developed. For example, the Non-Urban States claim that “[w]hen competition develops, states can make the currently implicit subsidies explicit and collect them from customers of all carriers, including those of CLECs.”<sup>32</sup> Ameritech also concludes that “states are currently providing for ‘comparable’ rates through implicit (or, perhaps, in some cases explicit) mechanisms. Further, as competition compromises the viability of any of these implicit subsidy mechanisms, states are expected to continue to provide similar levels of support through other means.”<sup>33</sup> These arguments are backwards. As long as there

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<sup>30</sup> *Id.*, ¶ 11.

<sup>31</sup> GTE Comments at 9-10.

<sup>32</sup> Non-Urban States Comments at 18 n.17.

<sup>33</sup> Ameritech Comments at 5.

are implicit subsidies, such as low-cost areas subsidizing high-cost areas and business rates subsidizing residential rates, there will never be real competition for most residential consumers. Without portable support targeted to high-cost areas, there will continue to be uneconomic competitive entry into urban areas, particularly targeting business customers, and no entry into high-cost residential areas. If states wait for residential competition before removing implicit subsidies, they will wait forever.

The California PUC argues that "basing federal support on costs measured by UNE zone or wire center costs, absent a cap equal to the current size of the federal fund, would place unnecessary burdens on funding states."<sup>34</sup> This is not the case. The options suggested by GTE would require future high-cost fund contributions of less than one percent of the funding base of interstate retail revenues. The current high cost fund support of \$88 million represents less than one tenth of one percent. Thus, GTE's proposals should not put an unreasonable burden on any state.

**V. MARKET FORCES WILL ENSURE THAT SUPPORT IS USED IN HIGH-COST AREAS AS LONG AS ETCS ARE REQUIRED TO OFFER A BASIC SERVICE PACKAGE AT AFFORDABLE RATES.**

In its Comments, GTE explained that the best way for the Commission to ensure that high-cost funding is used consistent with the requirements of Section 254 is to rely on market forces, rather than additional accounting regulations.<sup>35</sup> As long as high-cost support is distributed on a deaveraged basis and is portable, carriers will be forced to

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<sup>34</sup> Comments of the People of the State of California and the California Public Utilities Commission at 13.

<sup>35</sup> GTE Comments at 33-35.

use support in high-cost areas. If they do not, they will not be able to provide high quality services. They will then lose customers and the support that goes with them.

However, for market forces to work correctly, some regulatory action is needed. The Commission must require that as a condition of receiving funds, a carrier must offer at least one basic service package that (1) meets the Commission's definition of supported service and (2) is offered at a rate no higher than the level found by the state commission to be affordable. As GTE has shown, this requirement prevents carriers from creating expensive packages of services that would be affordable to only a small group of customers. If a carrier only offers packages with multiple services, including toll calls and vertical features, there is no way to ensure that funding is being used for supported services rather than other elements of the package. In addition, GTE's proposal does not place any unreasonable burdens on state regulators, who need only determine what the affordable rate for the state is and certify to the Commission that a carrier has a basic local service offering at this price.<sup>36</sup>

Other commenters agree that accounting regulations are unnecessary. For example, Western Wireless acknowledges that if a carrier "were to attempt to raise its rates to consumers to allow it to retain some portion of the subsidy and use it for other purposes, another competing carrier would offer universal service at a more reasonable rate, and would capture both the customer and the universal service support for that

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<sup>36</sup> As the Commission observed in the FNPRM, this certification would not be in the form of a requirement on the states, but would instead be a condition for receipt of funds from the federal high-cost program. If a state does not wish to make the necessary certification, it could decline federal funding.

customer.”<sup>37</sup> However, this market discipline will only be successful to the extent that each carrier is required to offer a basic service plan. Otherwise, there will only be competition among expensive packages of services, not the supported services themselves.

GTE acknowledges that, in its recent decision, the Fifth Circuit upheld the Commission’s decision not to require a basic service offering. However, the court did so with great skepticism, noting that:

[b]ecause the intended beneficiaries of universal service are, by definition, less able to afford even basic service, offering expensive bundled packages will allow new carriers to steal wealthier, low-cost customers while leaving ILECs such as GTE to provide service to everyone else....Allowing bundling would, however, completely undermine the goal of the first two requirements [of Section 214(e)], because a carrier could qualify for universal service support by simply offering and then advertising expensive, bundled services to low-income customers who cannot afford it.<sup>38</sup>

Its reason for upholding the Commission – that the Commission has committed to prevent companies from using bundling to avoid high-cost customers – is plain error. Moreover, the court’s decision does not prevent the Commission from adopting GTE’s recommendation. The Commission, the industry, and consumers would be far better served by allowing market forces (supplemented by the affordable basic local service offering requirement) to ensure that high-cost support is used consistent with Section 254 rather than by burdensome accounting rules.

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<sup>37</sup> Comments of Western Wireless at 14.

<sup>38</sup> USF Opinion at 45-47.

**VI. MOST COMMENTERS AGREE THAT THE HOLD-HARMLESS POLICY SHOULD BE IMPLEMENTED ON A CARRIER-BY-CARRIER BASIS.**

In the FNPRM, the Commission asked a number of questions regarding implementation of a hold-harmless policy. The majority of commenters confirmed that hold-harmless funds should be distributed directly to carriers on a carrier-by-carrier, rather than a state-by-state, basis.<sup>39</sup> As Sprint notes, if funds are given to state commissions:

once provided the lump sum amount, it [the state commission] would be free to redirect those monies away from high cost areas to unrelated subscribers or services, thus depriving the intended recipients of the support. Likewise, unless USF dollars are delivered to their intended destination, funding would not be available to new entrants seeking to enter high cost areas, negatively impacting not only the competitive neutrality of the funding mechanism, but the proliferation of facilities-based competition as well.<sup>40</sup>

Commenters that support state-by-state block grants claim that this will allow states to redistribute support among high-cost areas.<sup>41</sup> However, allowing redistribution will undermine the basis for the hold-harmless approach. The purpose of the hold-harmless policy is to ensure that carriers receive at least the same level of funding as they do now to prevent rate shock to high-cost customers.<sup>42</sup> If funds are given in block

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<sup>39</sup> See, e.g., Comments of BellSouth Corporation at 9-10; CBT Comments at 2; Comments of Puerto Rico Telephone Company at 7-8; Comments of SBC Communications Inc. at 9-10; Sprint Comments at 9-10; Comments of the United States Telephone Association at 5; U S WEST at 29-30.

<sup>40</sup> Sprint Comments at 9.

<sup>41</sup> See, e.g., AT&T Comments at 17-18.

<sup>42</sup> Order and FNPRM, ¶ 68.

grants on a state-by-state basis, there is no guarantee that carriers that have been required to establish prices based on current support levels will receive these funds, raising the possibility that a drastic change in rates will be necessary.

Despite this, MCI WorldCom asserts that the hold-harmless policy "will undermine competitive neutrality." First, MCI WorldCom states that "there also is no reason for the incumbent to receive more subsidy funds than needed to cover forward-looking costs. Hold harmless funding provides an unwarranted windfall to incumbent LECs."<sup>43</sup> This is not the case. As several incumbent carriers note, the proxy model consistently underestimates the costs of providing service.<sup>44</sup> Thus, rather than providing carriers with a windfall, the hold harmless funding will ensure that carriers have sufficient means to support high-cost areas.

Second, MCI WorldCom claims that:

[a]ny hold harmless clause will undermine competition by artificially favoring incumbents. If a carrier were held harmless, then it would continue to receive the same level of universal service funding even if it were no longer serving all the high-cost customers whose rates the universal service fund was intended to keep affordable and comparable."<sup>45</sup>

This is also incorrect. As GTE explained in its Comments, there is no inherent conflict between the hold-harmless policy and competition.<sup>46</sup> The hold-harmless funding should

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<sup>43</sup> MCI WorldCom Comments at 15.

<sup>44</sup> See, e.g., Bell Atlantic Comments at 3-4; Sprint Comments at 5-7.

<sup>45</sup> MCI WorldCom Comments at 14.

<sup>46</sup> GTE Comments at 39.

be portable. If a customer in a high-cost area changes carriers, the hold-harmless funding would "move" with that customer. Thus, the hold-harmless funding will encourage new entrants into high-cost areas, rather than undermining competition.

**VII. THE RECENT CONSENSUS PROPOSAL ON ACCESS CHARGE REFORM SATISFIES THE REQUIREMENTS OF THE ACT IN A COMPETITIVELY NEUTRAL MANNER.**

In its Comments, GTE outlined the basic requirements for any reform of ILEC access charges. First, the Commission must eliminate the implicit subsidies in access charges by, among other things, deaveraging the SLC. Second, where a deaveraged SLC exceeds the level consistent with affordable service, a competitively neutral universal service mechanism should provide the difference. Finally, any new federal funding to replace implicit support in interstate access should be offset by reductions in interstate access rates. As long as there is sufficient universal service funding, the CCL and PICC charges could be eliminated even with deaveraged SLC rates. This will ensure that low-cost customers are not subsidizing higher cost customers through implicit subsidies while allowing access rates to fall.

On July 29, 1999, AT&T, Bell Atlantic, BellSouth, GTE, Sprint, and SBC filed a joint proposal to reform interstate universal service high cost support and access charge rates and rate structures with the Commission.<sup>47</sup> This proposal would be an important competitively neutral step towards satisfying the Act's requirements. First,

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<sup>47</sup> Letter to Chairman William E. Kennard and Commissioners Susan Ness, Harold W. Furchtgott-Roth, Michael K. Powell, and Gloria Tristani from AT&T, Bell Atlantic BellSouth, GTE, SBC, and Sprint (filed July 29, 1999) (containing detailed proposal for universal service high-cost fund and access charge reform).



the plan provides for an increase in SLCs to recover more of the common line costs. Second, it allows for SLC deaveraging subject to certain limitations. Third, it provides for additional high-cost universal service funding to ensure that rates remain affordable.<sup>48</sup> This funding will be recovered in a separate rate element charged to all end users rather than through adjustments to the Price Cap baskets and services. GTE believes that this proposal represents a fair, competitively neutral, and economically reasonable mechanism for removing many of the implicit subsidies in access charges and will lead to lower long distance rates and increased competition in the local exchange market and urges the Commission should promptly put it out for public notice in order to permit implementation of the plan by January 1, 2000.<sup>49</sup>

## **VIII. CONCLUSION**

In its codification of universal service policy, Congress spelled out numerous requirements in Section 254. The Act requires the Commission to ensure that there is sufficient universal service funding for affordable, reasonable comparable rates. The Act also requires that the Commission do this without reliance on implicit subsidies.

The Commission has strived to implement policies that foster local competition since the passage of the Act. GTE submits that establishing a federal high-cost

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<sup>48</sup> This additional funding is designed to replace some of the implicit subsidies currently in ILEC access charges. However, this is not to be confused with the funds needed to make rates reasonably comparable among states, which the Commission's model estimates to be \$1.6 billion, as described in section II above.


<sup>49</sup> GTE will be providing the Commission with detailed comments on the proposal when it is put on public notice.

mechanism with sufficient funding which does not rely on implicit subsidies and which encourages states to end their reliance on implicit subsidies will be the largest single factor to bring about residential competition. Therefore, GTE urges the Commission to enact a federal high-cost mechanism consistent with the recommendations outlined above.

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